

**Remarks**  
**by**  
**ELLEN SEIDMAN**  
Director, Office of Thrift Supervision  
**at**  
America's Community Bankers Convention  
Chicago, Illinois  
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Last week marked my first anniversary as OTS Director. I have found the job very rewarding, especially when I can get out of Washington to talk to many of you in Town Meetings, conferences like this one and at other opportunities.

I've been impressed with what you are doing, and, all in all, you are doing a good job. You have taken advantage of the strong economy that has benefited us all. And you have been serving your communities well.

Since June 1996, the Treasury yield curve has steadily fallen and flattened. Declining interest rates sparked another refinancing and home-buying boom. Thrifts parlayed the demand into significantly higher mortgage origination volume, especially in the last quarter of 1997 and the first half of this year, which helped fuel record profits last year and in the first six months of 1998.

But now economic changes are occurring, and there are other developments creating new challenges for you. Over much of the past year, attention has been focused on structural issues. But as a regulator, I think it's important to raise some of the more general economic issues that challenge the industry. Of course, each institution must evaluate itself and be evaluated on its own merits. However, a few generalizations are in order.

First, over the past several years, thrift earnings have been buoyed by declining loss provisions. But now, the bad assets are used up, and increasing loss allowances may once again become appropriate for some institutions.

The industry has also benefited from unusually low mortgage delinquency rates, primarily because of the exceptionally good loans booked during the 1992-1993 refinancing boom. While mortgage delinquencies remain very low, post-1993 cohorts have not performed as well.

After a long period of improving earnings efficiency, we've seen a slight decline, which is probably attributable to increased costs associated with high-volume mortgage banking activities. The challenge will be that which faces all mortgage bankers: to reduce G&A quickly as originations decline.

Finally, the industry's net interest margin has held steady. But in this interest rate environment, steady – or increasing – net interest margins may be a signal to look closely

at the composition of earnings. Some who have steady margins are doing a good job of balancing risk and return, and are effectively managing their move out the curve. And some whose net interest margins have declined a little are, in fact, positioning themselves for the long term. What's important is the sustainability of earnings. That's what we'll be looking for.

If you're contemplating moving into new businesses, you need to analyze your appetite for risk, your competence, your systems and your market, and do some thoughtful strategic planning – not just for the next 12 months, but for the next several years. I suggest you focus your attention on three principal areas of potential risk: credit quality, profitability and the Year 2000.

Identify specific competitive advantages you have, such as community ownership, strong personal services, favorable local image and efficient cost structure, and use them to reinforce your market clout. And then exploit your niche, and play to your strength. You know best the financing needs and credit risks of your current customers. Take maximum advantage of that knowledge, and extend your successful product lines to new customers in your market areas.

Of course, it is important not to ignore interest rate risk, the perennial concern of the thrift industry. We will continue to work with you to evaluate your sensitivity and exposure. If it makes sense in your individual situation, use the current economic conditions to pay down borrowings and rebuild your deposit base to improve your cost structure.

Now is especially the time to manage your business to minimize volatility, understanding that interest rate risk started the problem in the 1970s and 80s, and credit risk was what brought down the house. By focusing on profitability and keeping an eye on interest rate cycles, you can survive and prosper.

## CRA

When regulators revised the CRA rules in 1995, we indicated we would review them again in 2002. I think on balance we got it right then and produced a rule that is flexible, performance-based, and fair. But several "big picture" issues and some substantive implementation concerns warrant our attention. They are simply too important to ignore.

Without a responsible fix, the good, positive work already done to revise CRA regulations may be eclipsed by rampant criticism. What is influencing my view?

For one thing, more and more institutions, including "traditional institutions," are using alternative product delivery systems outside the traditional brick and mortar branch structure. The reach of these systems, including mail, telephone, loan production offices, agent and affinity relationships, or even the Internet, transcends the geographically focused evaluation criteria that underpin CRA regulations. The revised rule simply isn't the best fit for all those institutions do.

We are also witnessing the emergence of so-called “mega-banks” with their national marketing reach and technologically sophisticated independent mortgage companies. Their lower-priced loan products and more efficient application processing can take a big bite out of the business of smaller, community-based institutions. I’m convinced we need to better understand this phenomenon and make certain the CRA regulations are effectively motivating all banks and thrifts to improve the communities in which we all live.

As I’ve crisscrossed the nation this year, I’ve stressed the value of partnering. For example, we have seen small institutions in largely rural communities partner with the USDA Rural Housing Services to provide home loans through the leveraged loan program. And some metro-based institutions, that have successfully tackled their local credit needs, have shown a willingness to seek direct lending or community investment opportunities outside their assessment areas in these rural communities. We also continue to see alliances with other lenders, businesses, non-profits, governments, and intra-industry consortia.

We can encourage these initiatives by expanding the degree of favorable CRA consideration that institutions receive for out-of-assessment area lending and services, and by enhancing and regularizing the weight given for creativity and innovation. Don’t get me wrong, I’m NOT suggesting we ditch the current CRA regulations and start over.

I AM suggesting we take advantage of the regulation’s inherent flexibility to address marketplace issues that simply were not significant a few years ago, but will become even more so in the near term.

CRA is important. It’s my goal to make it more workable in today’s environment. I think recent suggestions that institutions under \$250 million in assets be exempt were misplaced and counterproductive. That would affect nearly two-thirds of the institutions we regulate. And I can assure you that even today, not all of them lend and serve on both sides of the tracks.

What the nation needs is more broadly available financial services and more community development, not less, to provide decent affordable housing and more job opportunities and community services.

### **Year 2000 – the Millennium Bug**

What with global turmoil, the changing economy, flat yield curve and intense market competition, who needs any more challenge! But there it is – Y2K, Year 2000 conversion, the millennium bug – by any name a challenge. Here’s where your efforts need to be well along, because there are only 14 months until the Year 2000. Results of the on-site examinations completed in early summer tell us that, by and large, the bank and thrift industries are where they ought to be in their preparation. We – and you – are now in the toughest part of the readiness schedule, the testing and contingency planning

stage. The current round of examinations, when completed next year, will give us a much clearer picture of the industry's readiness.

Hopefully, the passage of legislation that provides some protection against liability will allow for improved communications between the financial services industry and the energy and telecommunications industries, so we can find out more about their preparation. Likewise, you will have more leeway to keep your customers apprised of your own readiness. You cannot tell them your Y2K exam rating, but you can do a number of things to help alleviate their fears that their accounts – especially access to and insurance of their demand accounts – will somehow be in jeopardy come January 1, 2000.

We and the other regulators also are working with John Koskinen, who is the President's Y2K czar. John is doing an excellent job going around the country encouraging readiness and discussing the government's progress. We are working with him as part of a financial services working group.

#### **Privacy Policy Announcement**

Notwithstanding the problems of Y2K, we all have benefited in one way or another from the computer age. With widespread use of this technology, however, issues arise over safeguarding customer information.

While institutions already have internal controls in place to protect paper-based customer information, they now face new challenges brought on by the electronic storage and retrieval of that information. New technology increases the potential for misuse or alteration.

OTS has studied this situation carefully and decided to take action. I am announcing today a new policy statement on privacy that is being sent to every institution we regulate. It will also be on our web site at [www.ots.treas.gov](http://www.ots.treas.gov). The policy makes the following key points:

- Thrift institutions have an obligation to protect and maintain confidential and accurate customer account information.
- Each institution should establish adequate controls to ensure that customer information is properly protected, confidential and used as agreed with the customer.
- If an institution wants to use customer information for purposes other than its own internal business purpose, such as cross marketing products of an affiliate, then the customer should be told and given the opportunity to limit such use, or "opt out."

The disclosure and opt-out provisions are already requirements for providing personal customer information to affiliates under the Fair Credit Reporting Act. We are simply urging the institutions we regulate to apply that control to all information sharing situations. This policy statement and applicable laws and regulations will be considered by OTS examiners as they evaluate the adequacy of an institution's controls.

Safeguarding customer information is an evolving area. Both domestic and international considerations are driving this issue, and efforts are under way to establish standards governing the use of customer information. OTS will continue to monitor and update its policies as needed. The guidance being issued today is by no means the final say on this matter, but it is guidance that is timely and necessary.

I want to remind you and caution you that there are outside hackers, disgruntled employees and others, who may intentionally, or more often unintentionally, create havoc with your customer information if you fail to establish adequate operating controls. The policy statement outlines the elements of a comprehensive security program that would reduce this risk.

In addition, you need to be aware of the efforts of "information brokers" to obtain confidential customer information through the practice known as "pretext phone calling." OTS is recommending that institutions establish policies and procedures that include clear guidelines for disseminating customer account information, and not rely on employee discretion to determine whether or not it is appropriate to disclose confidential information.

You will be receiving the new privacy policy, the interagency memorandum and a CEO letter from OTS Deputy Director Rick Riccobono. I hope you will look for these documents and read them carefully. The recommended procedures to protect your customers' privacy are very important.

### **Closing Statement**

I would be remiss if, before sitting down, I did not mention H.R. 10. Frankly, many of us were surprised by how far the modernization motorcade traveled after 20 years of stop and go effort. Many people worked very hard on the legislation, not only Members of Congress, but also our colleagues in the other banking agencies, Treasury, your representatives and those of the banking and other financial services industries, community and consumer groups and our own staff at OTS.

At the end, there remained key areas of contention, including the threat to CRA and the question of how to structure commercial activities in banks. These issues obviously will have to be resolved before financial modernization achieves reality. We are gratified, however, by the recognition in both houses of the federal thrift charter's continuing value in the financial marketplace. We look forward to continuing to enhance that understanding and recognition in the 106<sup>th</sup> Congress.

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